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BellSouth
Suite 900
1133-21st Street, N.W.
Washington, D.C. 20036-3351

robert.blau@bellsouth.com

Robert T. Blau, Ph.D., CFA
Vice President-Executive and
Federal Regulatory Affairs

202 463-4108
Fax 202 463-4631

September 3, 2002

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SEP - 4 2002

Ms Marlene H. Dortch
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: WC Docket No. 01-339

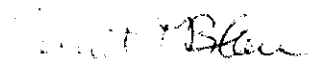
Dear Ms Dortch:

This is to inform you that on August 29, 2002, Duane Ackerman, Margaret Greene, Herschel Abbott, and I, all representing BellSouth, met with Commissioner Michael Copps and his senior legal advisor, Mr. Jordan Goldstein to discuss some of the more pressing financial challenges facing local exchange carriers, and the telecom industry more generally.

Topics addressed during the course of this meeting are summarized in the attached presentation. In addition to explaining various factors that are contributing to financial turmoil throughout the telecom industry, we discussed steps that the Commission could take to help restore investor confidence. These included paring back the number of unbundled network elements that BellSouth and other incumbent local exchange carriers are required to provide at non-compensatory TELRIC rates.

In accordance with Section 1.1206, I am filing two copies of this notice and request that you place it in the record of the proceeding identified above. Thank you.

Sincerely,


Robert T. Blau

cc: Commissioner Copps
Jordan Goldstein

Attachments

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Wireline Telecommunications: Situation Analysis and Recommendations

August 29, 2002

Executive Summary

- The Telecom industry is caught in the midst of a crisis created by four dynamics which have together resulted in massive excess industry capacity:
 - Internet “explosion”
 - Technology competition
 - Telecom Act Implementation - Economic downturn
- The combination of these dynamics has created a situation that carries huge, *long-term* negative implications for telecom investment, innovation and universal service.
- The number of business failures with the industry and the nature of bankruptcy law will exacerbate the situation.
- Specific changes in the regulatory framework provide the single best lever to stabilize the sector in the near-term.

Discussion Outline

■ Current Industry

■ What Happened?

■ Proposed Solutions

Current State of the Telecom Industry

- **As a significant part of the U.S. economy as well as the core infrastructure, the Telecom industry has the potential to be a long-term drag on the overall economy's growth and productivity.**

- **Massive Excess Capacity.** Industry analysts estimate that less than 97% of the fiber in the US has been lit.

- **Diminished Investor Confidence and Constrained Access to Capital.**
 - » 6 of 7 major domestic wireline carriers' debt has been downgraded since January 2000. Of these companies, two are rated as "junk" and two others are near junk status.
 - » Equity capital raised by Telecom carriers has declined from \$31B in 1999 to \$7B in the first half of 2002.

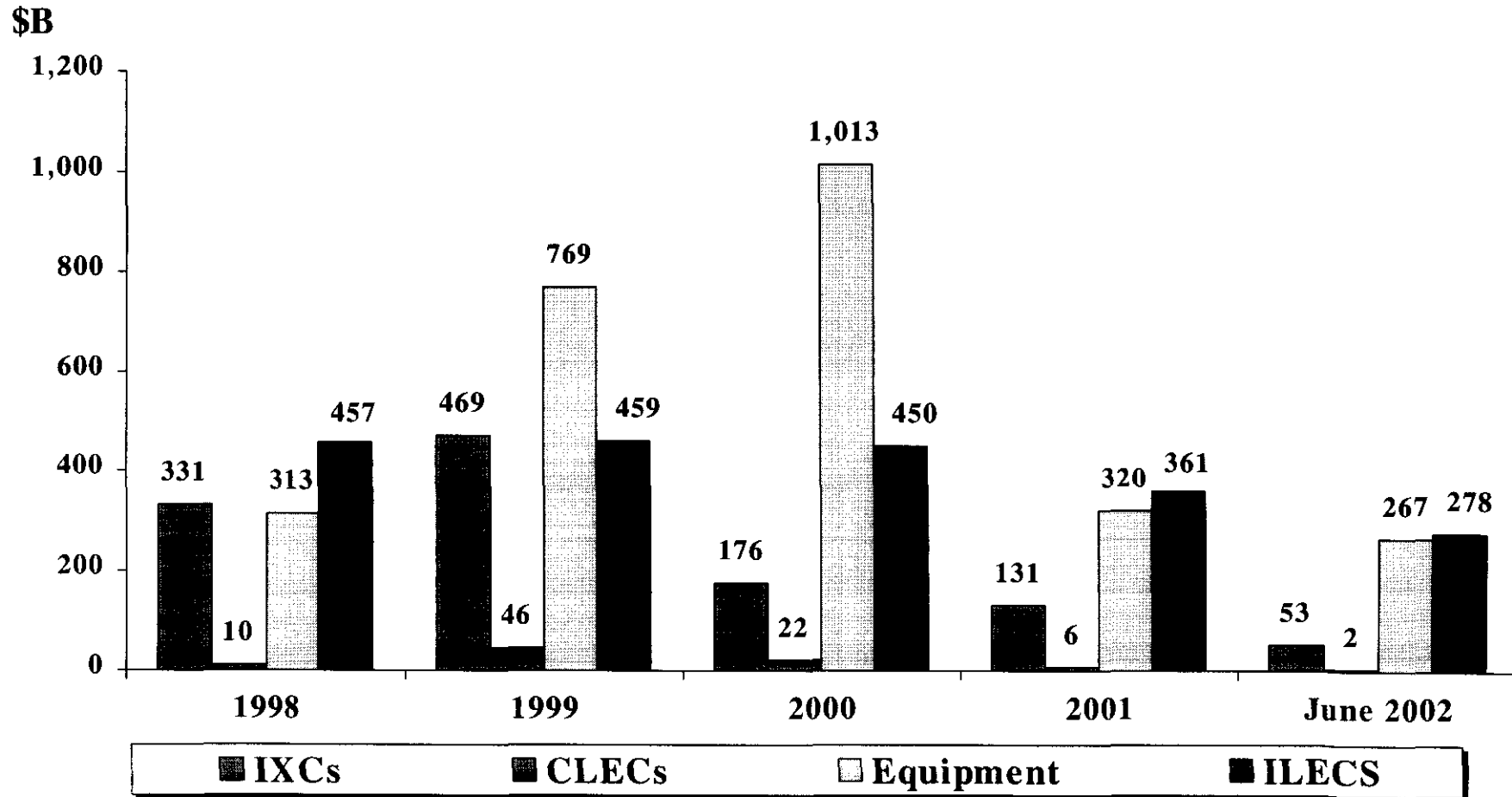
- **Reduced Capital Spending / Innovation.** Annual Telecom capital spending will decline from \$97B in 2001 to a projected level of \$69B in 2002 (28%).

- **Declining Revenue Growth.** Telecom industry revenue growth has declined from 11% in 1998 to -3% in 1st Qtr 2002.

- **Widespread Layoffs and Bankruptcies**
 - » Over 80 bankruptcies have been filed in the Telecom sector since January 2000.
 - » Telecom layoffs have exceeded all industries in 9 of the last 12 months, and announcements total more than 600,000 since January 2000.

Current State of Telecom Industry

- The implosion of the Telecom industry has resulted in the destruction of \$1.4 trillion in shareholder value (from each segment's high point).

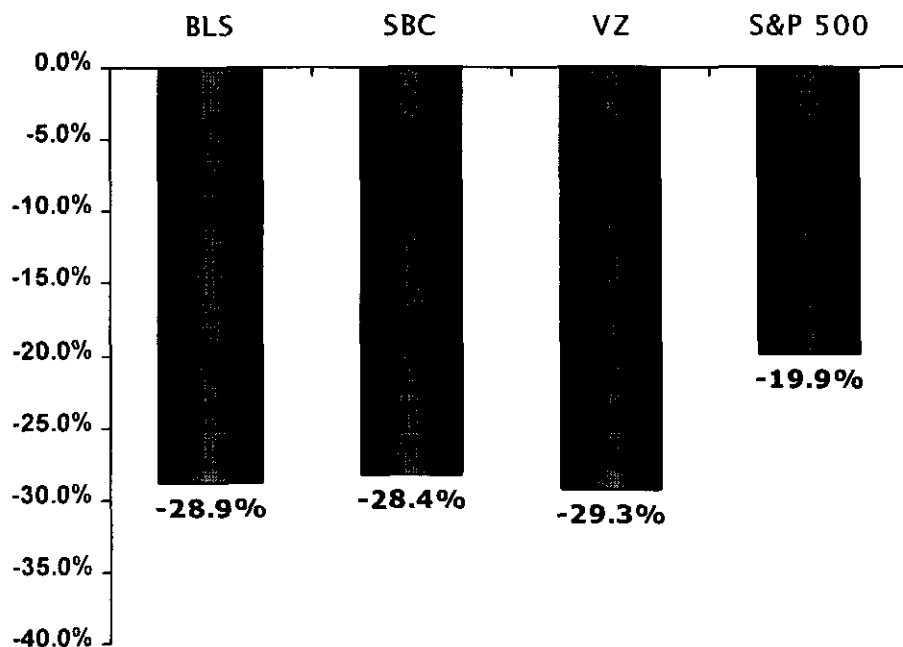


Current State of Telecom Industry

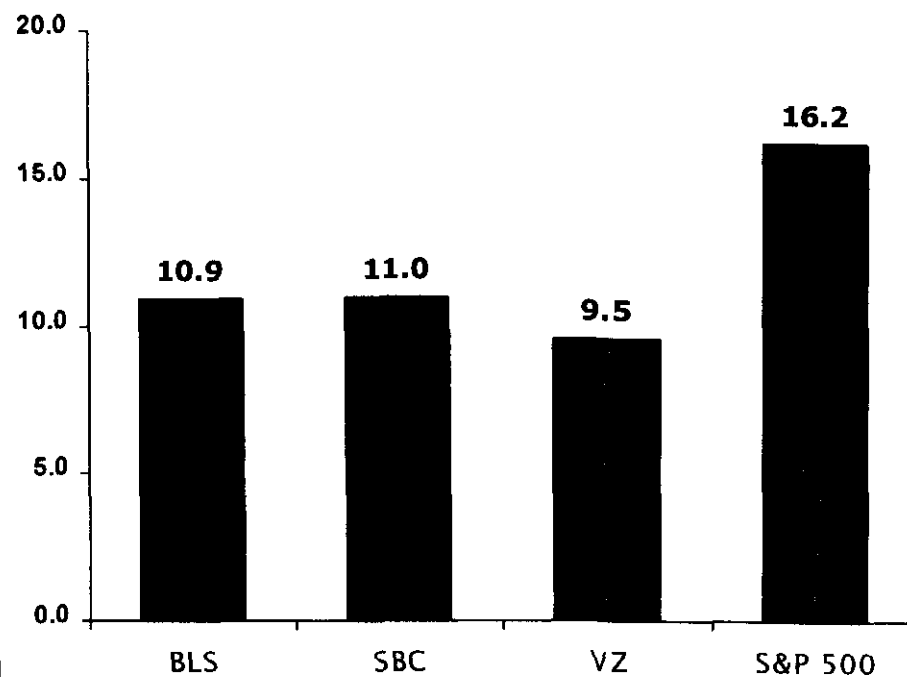
- Far from being immune, ILECs are increasingly viewed as high risk due in part to heightened analyst understanding of UNE-P impact. BellSouth, along with the other ILECs, are trading at historically high discounts to the market.

2002 Shareholder Returns

Through 8/5/02

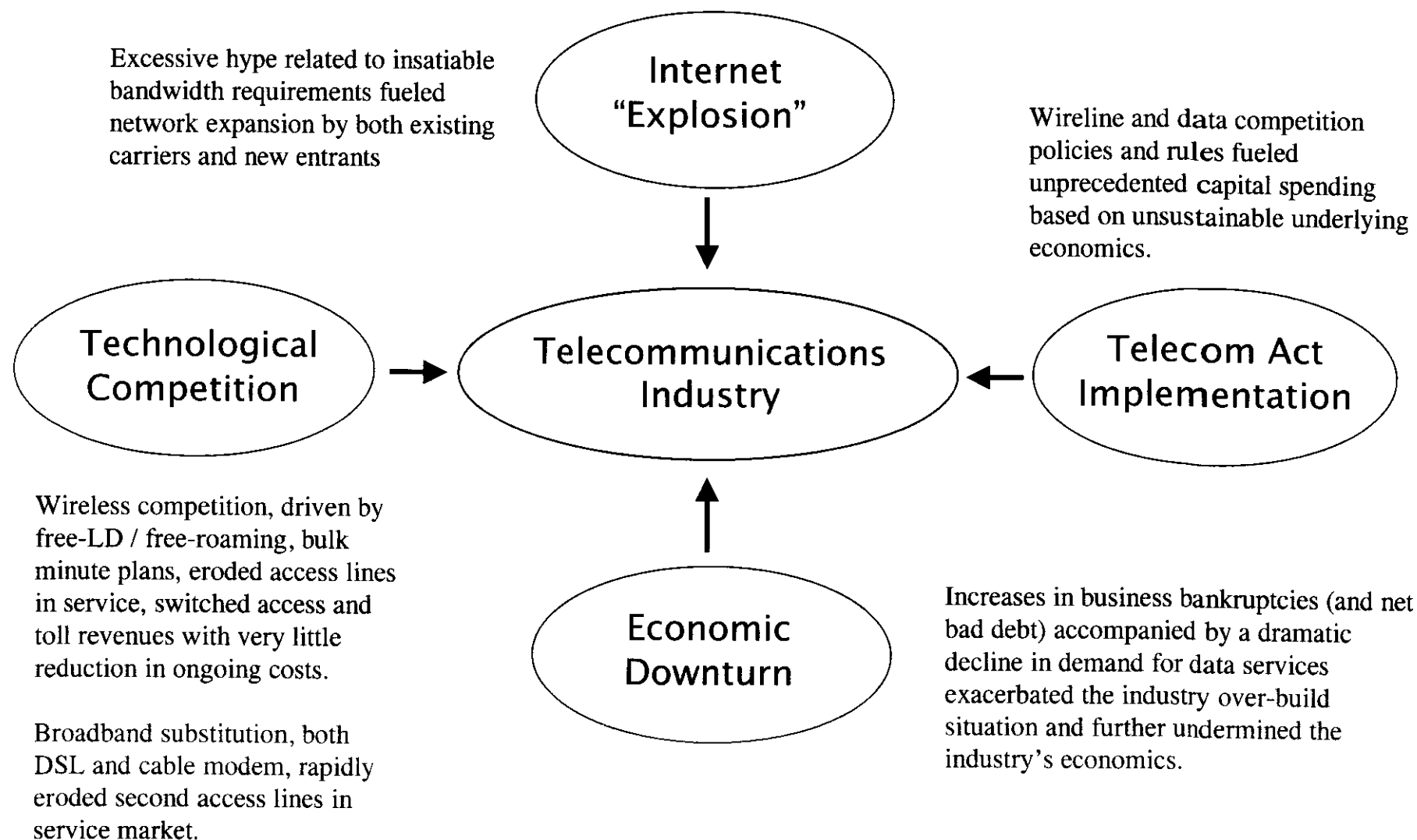


Current P/E Comparisons



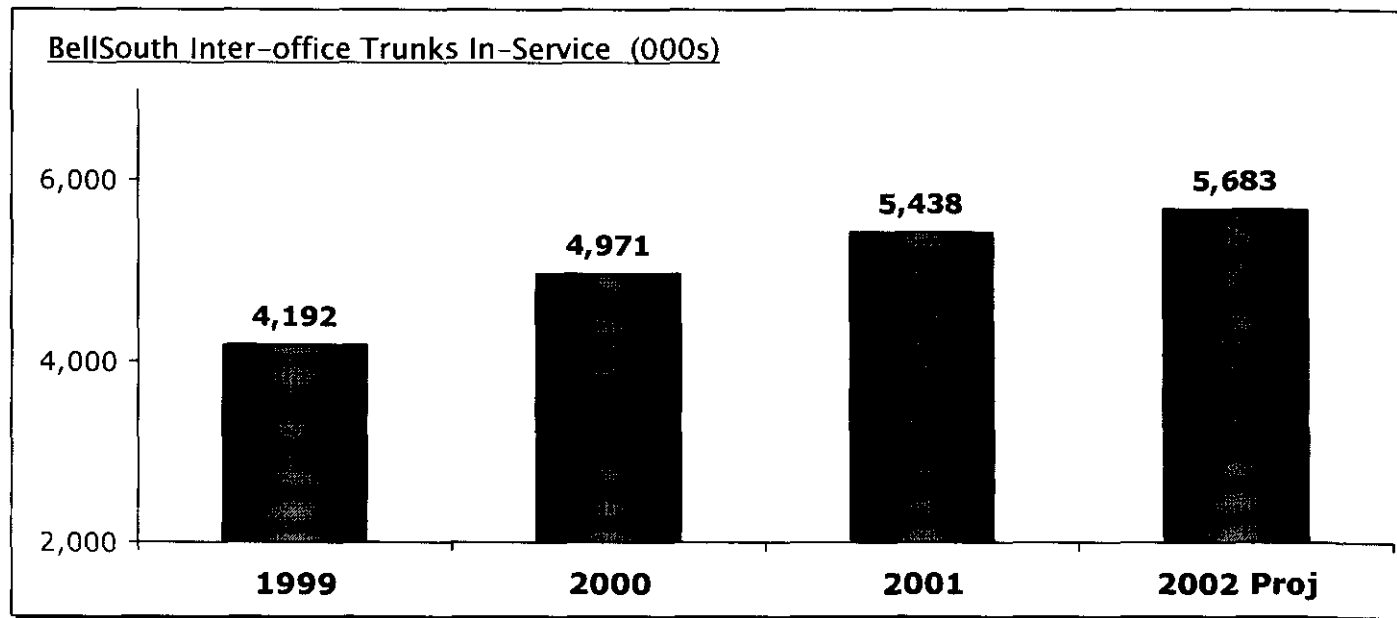
What Happened?

- **The massive excess capacity within the Telecom industry is the result of four contributing dynamics.**



What Happened - Internet "Explosion"

- **Although Internet growth did not meet publicized expectations, the annual doubling of Internet traffic dramatically increased the permanent cost of maintaining the PSTN.**
 - Flat-rate Internet pricing, enabled by the FCC's exemption from per-minute access charges, increased the design requirements for the PSTN by adding longer call duration traffic to the network. The call duration of dial Internet access traffic is estimated to be six times longer than traditional voice traffic.
 - As a result, the combination of CLEC and Internet growth substantially increased ILEC inter-office trunk requirements. The ILECs earned virtually no incremental revenue on this incremental investment.



What Happened – Economic Downturn

- **While not the cause of the Telecom industry implosion, the economic downturn exposed systemic industry issues sooner, creating an environment where businesses are retrenching and Carriers are grooming their networks.**

- In-region business bankruptcies have substantially increased in 2002. In BellSouth's Large Business market, new voice access line connections have declined 47% in the first half of 2002 relative to the same period in 2001.

- In BellSouth's Carrier market, growth in hi-cap services (a \$1.1B revenue stream in 2001) has declined from 33% growth in the first half of 2001 to -2.5% in the same period of 2002.

- The growth rate in total BellSouth wireline Data revenues (a \$4B revenue stream in 2001) has declined from 24% in 2001 to only 6% in the second quarter of 2002.

- The downturn in the internet market has driven a 25%, or \$100 million, decline in BellSouth's revenues from Internet Service Providers (ISPs) in 2002.

- Net bad debt has increased across all segments of the wireline business. Year-to-date, BellSouth's uncollectibles expense is 80%, or \$127 million, higher than 2001.

What Happened – Telecom Act Implementation

➤ **Implementation of the Act:**

- Successfully stimulated wireline competition
- Eroded ILEC margins while increasing fixed costs
- Delayed entry into long distance diminishing revenue opportunities

What Happened – Telecom Act Implementation – Competition

➤ **Competitive activity in the BellSouth region continues to be robust.**

- 354 CLECs providing local telephone service (**up 61, or 21%** since January 1st) to over 4.4 million lines.

- » 3,930 collocation arrangements in 548 wire centers
- » 297 operational Competitor switches
- » 259 operational points-of-interface (POIs) connected to the BellSouth network

- Competitive lines served on the BellSouth network:

- » Resale: 543K (2.1% of total lines)
- » UNE-Platform: 1,115K (4.3% of total lines)
- » UNE Non-Data Loops: 365K (1.4% of total lines)
- » UNE Data Loops: 40K

- Estimated additional Competitive lines served **entirely off the BellSouth network**: 2,305K (8.4% of total lines)

- Estimated BellSouth Retail Market Share:

- » Residence: 15,755K (92% of total residence lines)
- » Business: 5,887K (**66%** of total business lines)

What Happened – Telecom Act Implementation – Competition

Competition was introduced by imposing a hypothetical cost-based wholesale rate structure into a historical social goal-based retail rate structure.

Actual Monthly BellSouth Service Rates (as of 8/15/02)

	Metro	Rural	Metro	Rural
AL	16	15	36	36
FL	11	7	30	20
GA	17	12	48	25
KY	18	14	33	35
LA	13	11	33	29
MS	19	15	37	35
NC	13	10	34	28
SC	15	13	43	33
TN	12	8	40	27

Metro	Rural
13	34
13	33
14	26
11	31
13	48
12	44
12	34
15	27
13	23

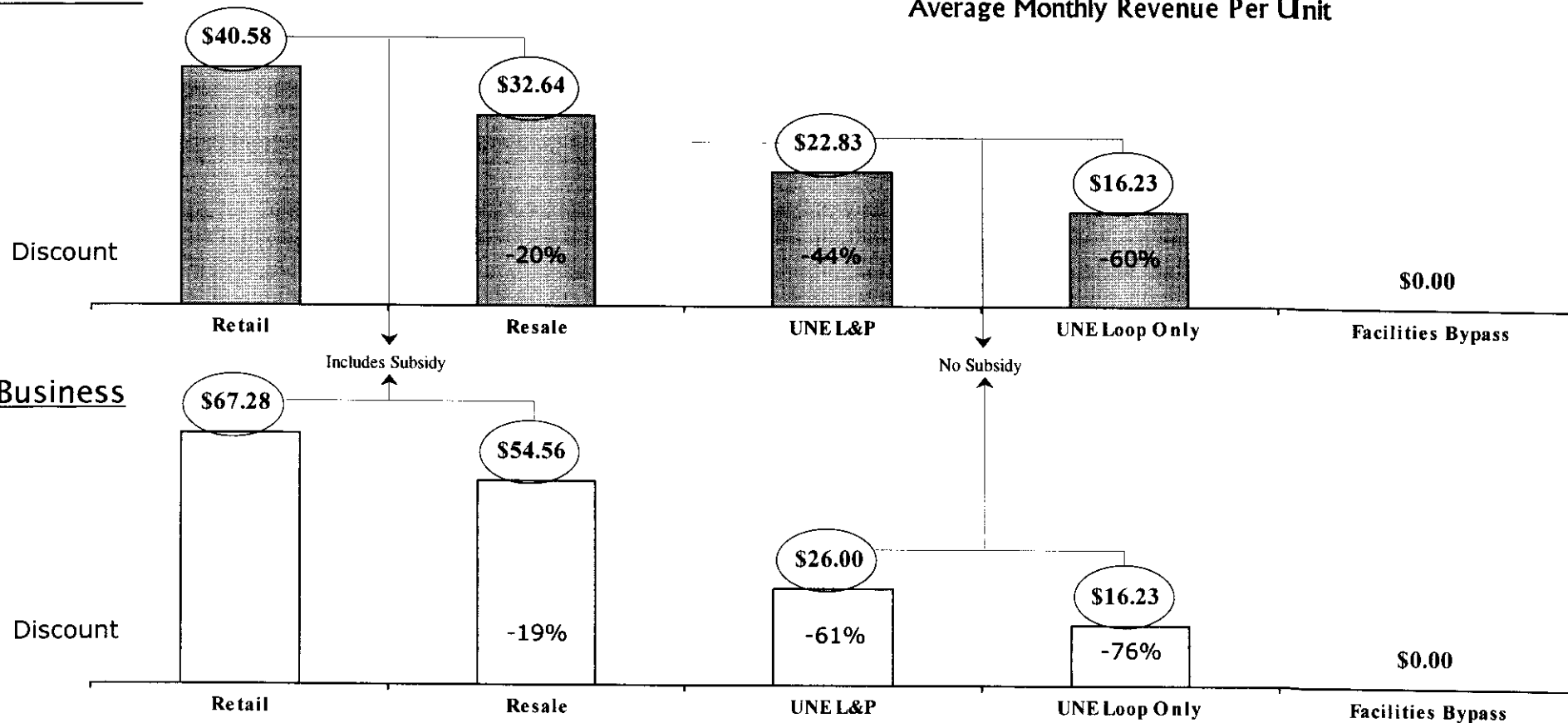
Metro	Rural
16	38
16	35
17	26
14	35
18	55
16	49
17	37
19	31
17	26

What Happened – Telecom Act Implementation - Uneconomic Competitive Rules

- UNE pricing (set at roughly one half ILEC Retail rates) has been the primary mechanism to accomplish this competitive “end”...

Residence

Average Monthly Revenue Per Unit

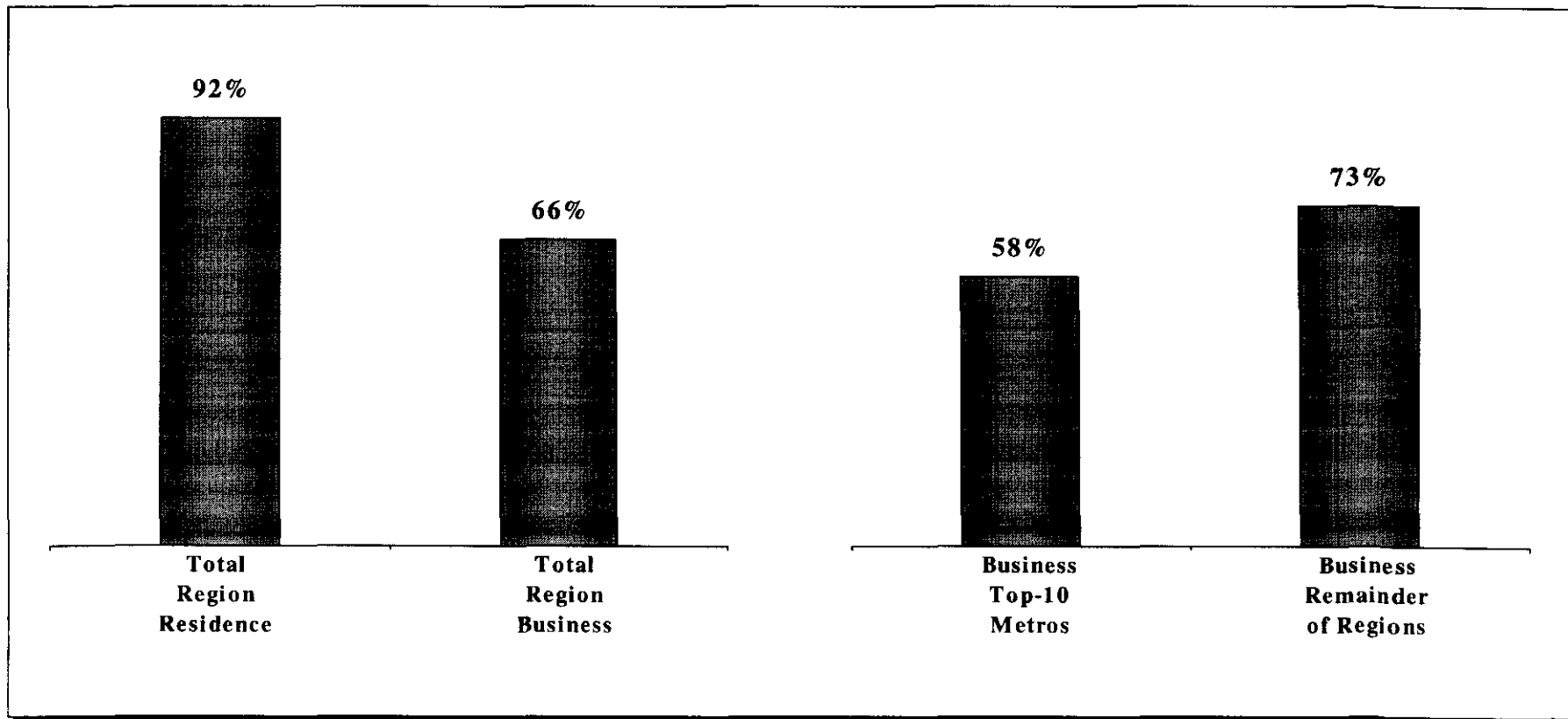


... placing ILECs at a significant competitive disadvantage in that they bear the entire framework of subsidies built into their rates (where margins are richer in business than residence, and in urban than rural), allowing CLECs to cream-skin the highest value customers ...

What Happened – Telecom Act Implementation - Uneconomic Competitive Rules

- ... The pattern of cream-skimming is evident in BellSouth's market share activity ...

% BellSouth Retail Market Share



What Happened – Telecom Act Implementation - Uneconomic Competitive Rules

- Most importantly, UNE prices (predicated on the theoretical costs to build and maintain a theoretical network that will never exist) have resulted in pricing to ILEC competitors below actual costs . . .

Georgia - Business	Retail	UNE-P	% Change
Revenue			
Basic Service	\$ 52.85	\$ 21.91	
Features & Other Services	\$ 11.25	-	
SWA/ LIC	\$ 4.10	\$ 0.09	
Total Revenue	\$ 68.20	\$ 22.00	-68%
Expense			
Customer Care	\$ 3.26	\$ 4.37 [1]	
Line Maintenance	\$ 3.51	\$ 3.51	
Asset-Related	\$ 6.12	\$ 6.12	
Uncollectibles	\$ 0.57	\$ 0.64 [2]	
Total Expense	\$ 13.46	\$ 14.64	9%
Product Contribution	\$ 54.74	\$ 7.36	-87%
Non-Product-Specific Shared Costs	\$ 9.29	\$ 9.29	-
Pretax Margin	\$ 45.45	\$ (1.93)	-104%

[1] Retail per unit costs lower due to scale and absence of unique customer interface arrangements.

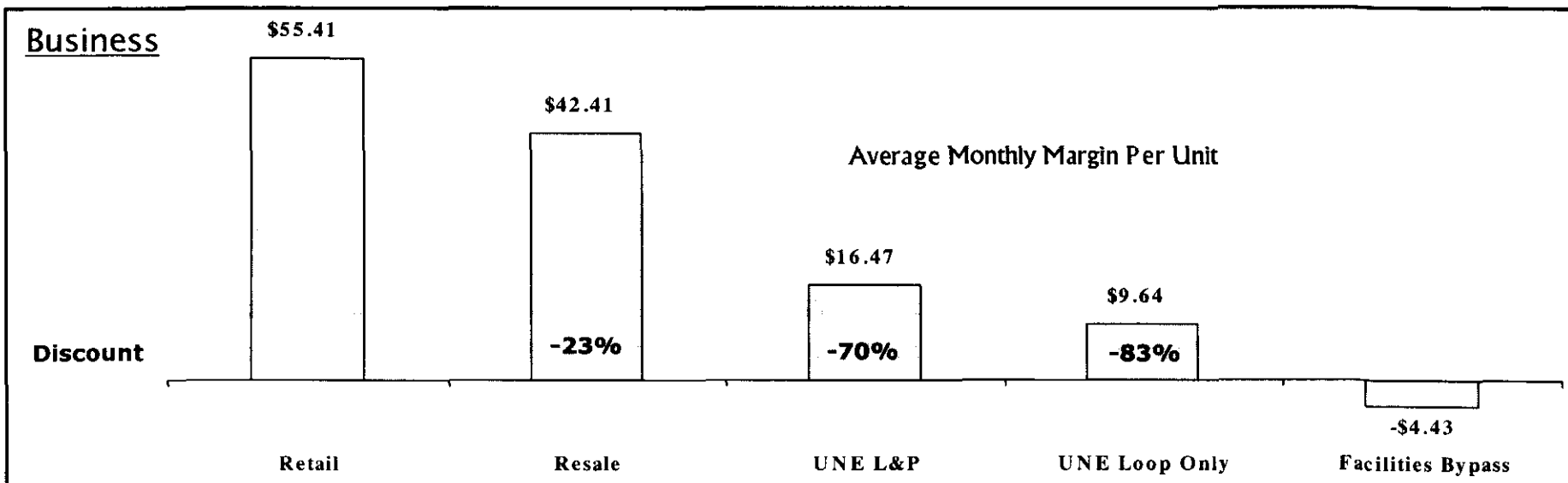
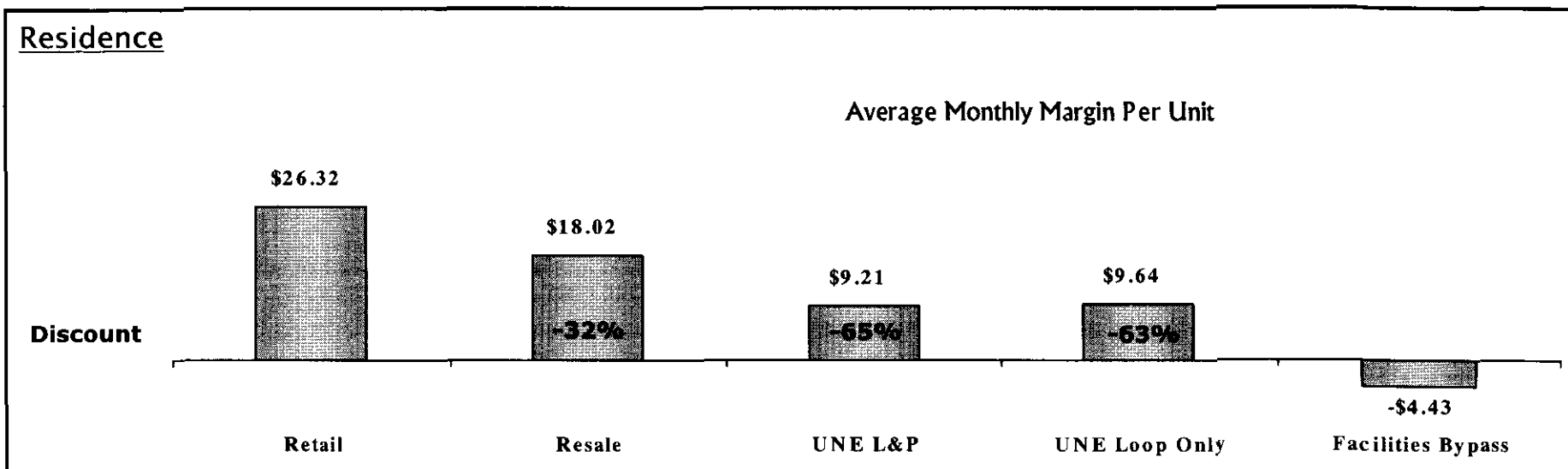
[2] Wholesale uncollectibles expense has been approximately three times the Retail level due to business failures.

Source: BellSouth Activity-Based Accounting System

. . . The financial burden on the ILECs associated with UNE-P pricing is magnified since UNE-P lines actually carry higher costs than Retail lines. This combination literally bleeds the profitability out of the ILECs.

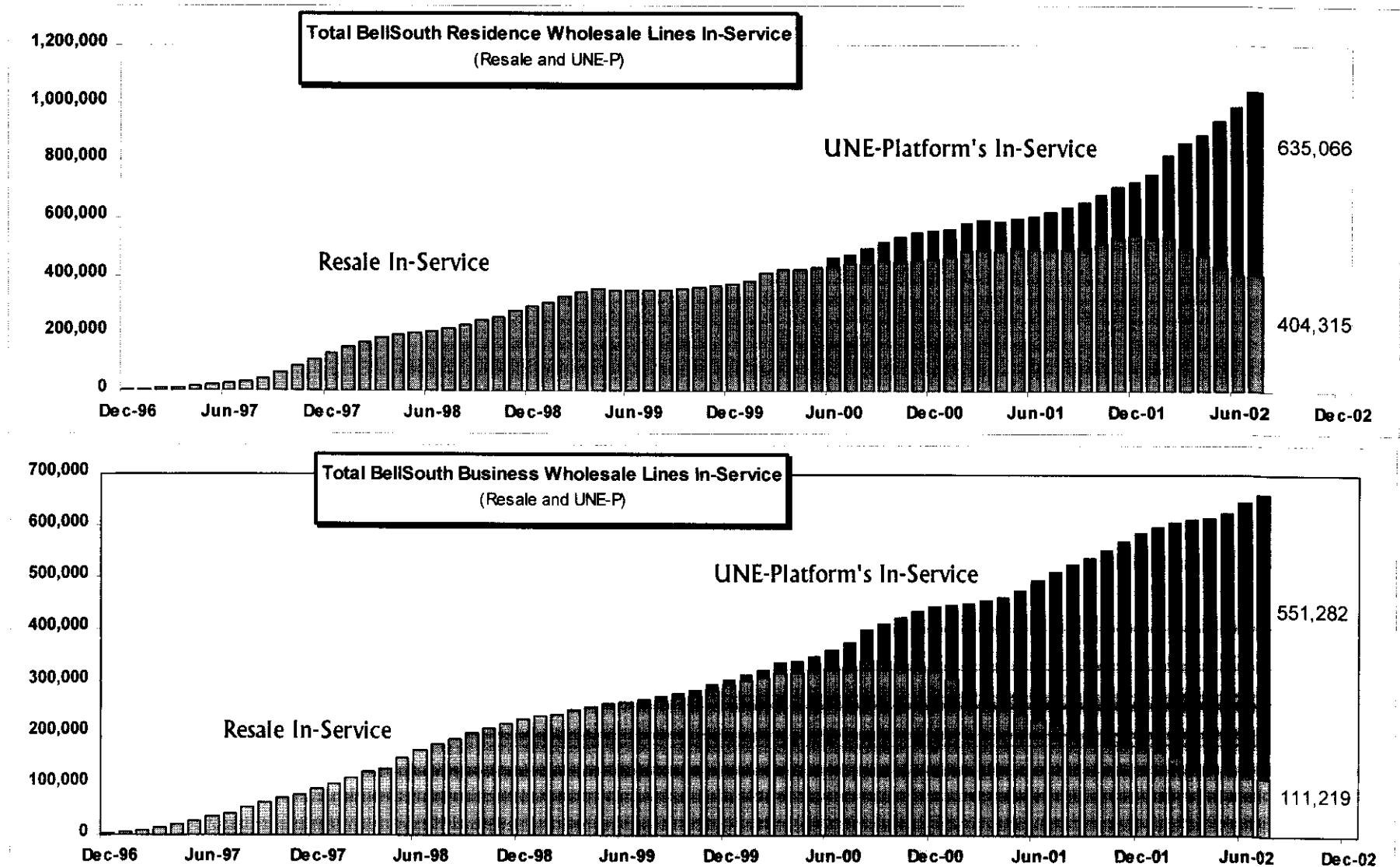
What Happened – Telecom Act Implementation - Uneconomic Competitive Rules

- On a regional basis, BellSouth's margins decline by 65% to 80% under UNE pricing relative to retail pricing.



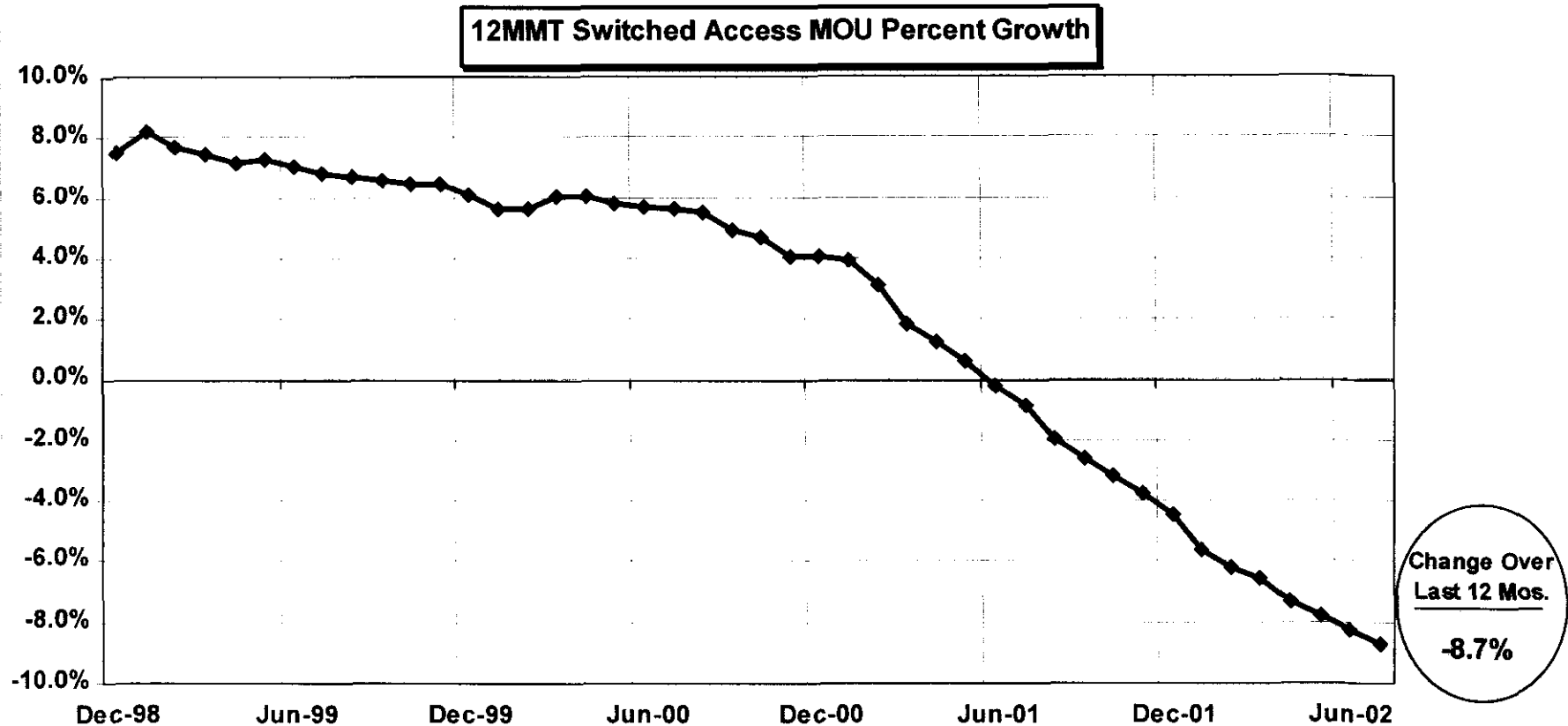
What Happened – Telecom Act Implementation - Competition

- Not surprisingly, the growth in wholesale access has shown little evidence of the financial turmoil as few competitors have discontinued, or even slowed, operations while in bankruptcy and as more competitors jump on UNE-P capturing the arbitrage opportunity.



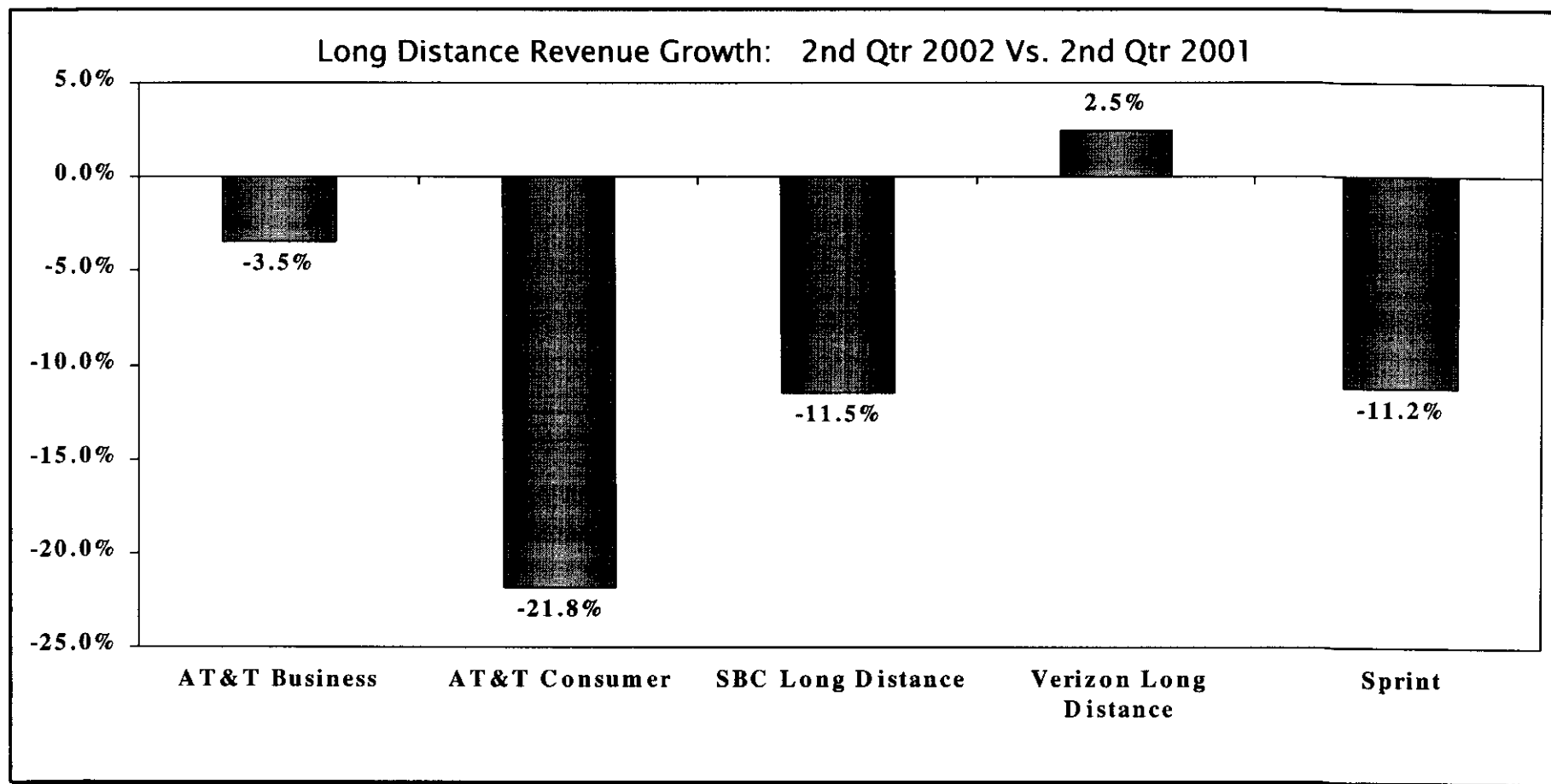
What Happened – Telecom Act Implementation - Competition

- In addition to margin pressure caused by UNE-P, the change in network usage, which drives BellSouth's \$1.0B Switched Access revenue stream, also provides evidence of competitive line loss and wireless competition and it further erodes financial stability.



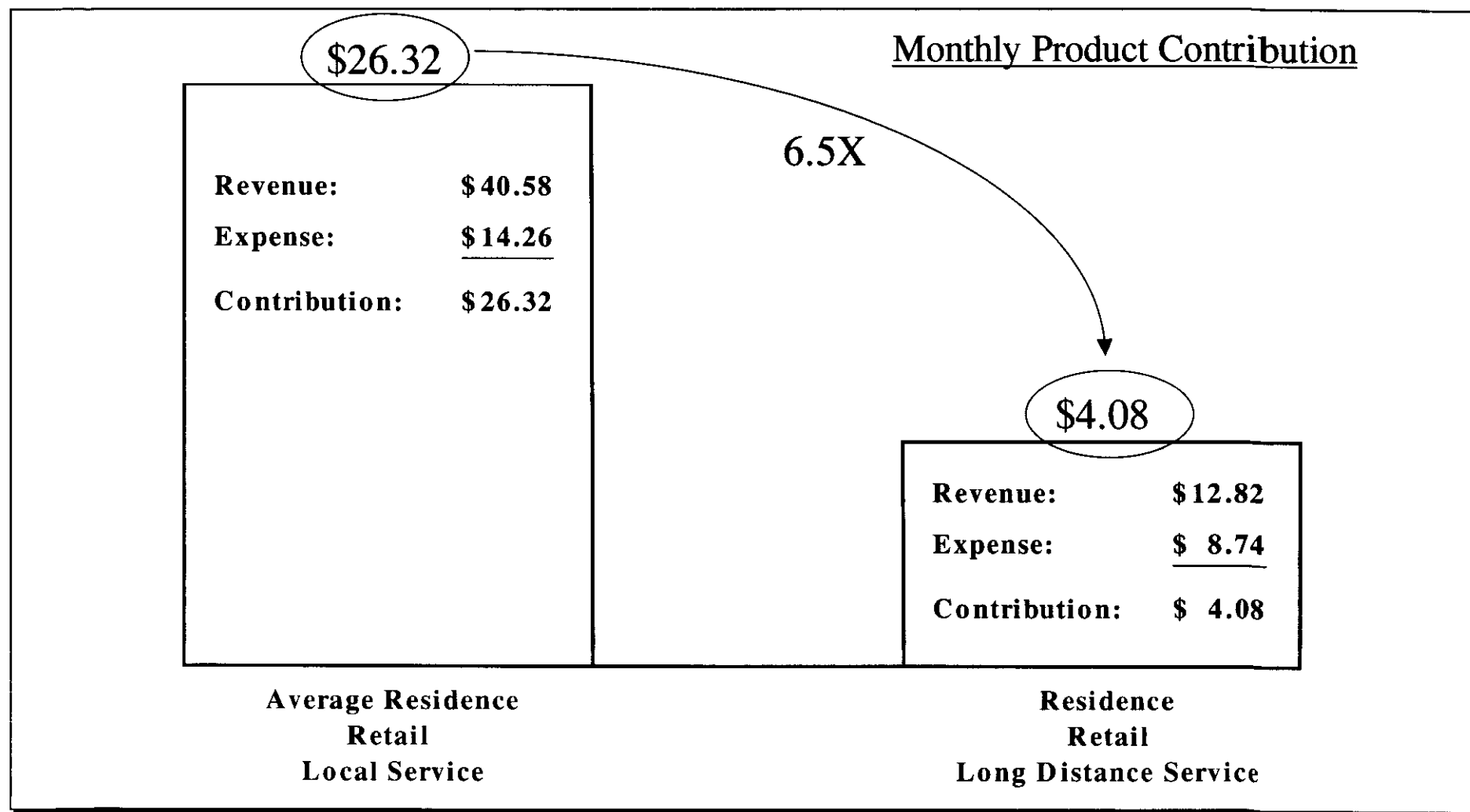
What Happened – Telecom Act Implementation – Competition – New Products

- While still critical to BellSouth's product "bundle," the revenue and contribution growth potential associated with Long Distance is limited as a result of intense wireline and wireless competition. Long Distance will not fill the gap created by UNE-P.



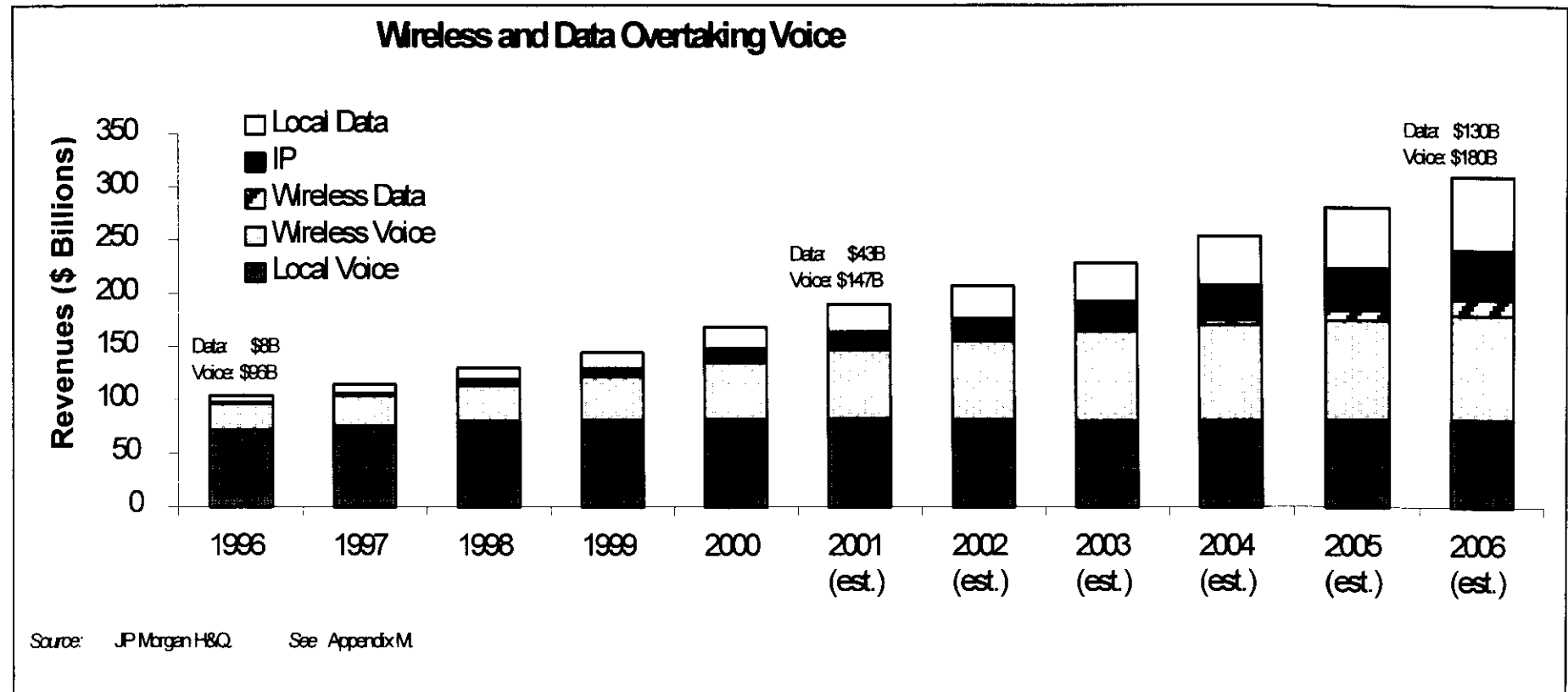
What Happened – Telecom Act Implementation – Competition – New Products

- Driven by wireless competition and excess capacity, long distance margins have declined significantly. It now requires six and one half new long distance customers to replace the monthly contribution margin associated with one local service customer.



What Happened – Technological Competition

- With growing inter-modal competition, role of wireline local voice is rapidly declining as traffic moves to wireless and data networks. Yet regulation remains singularly focused on wireline.

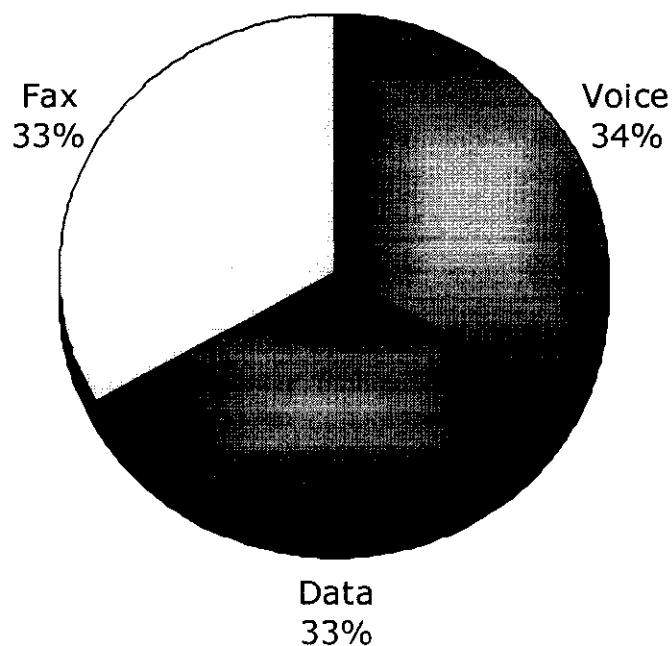


Fact Report reference: p. I-15

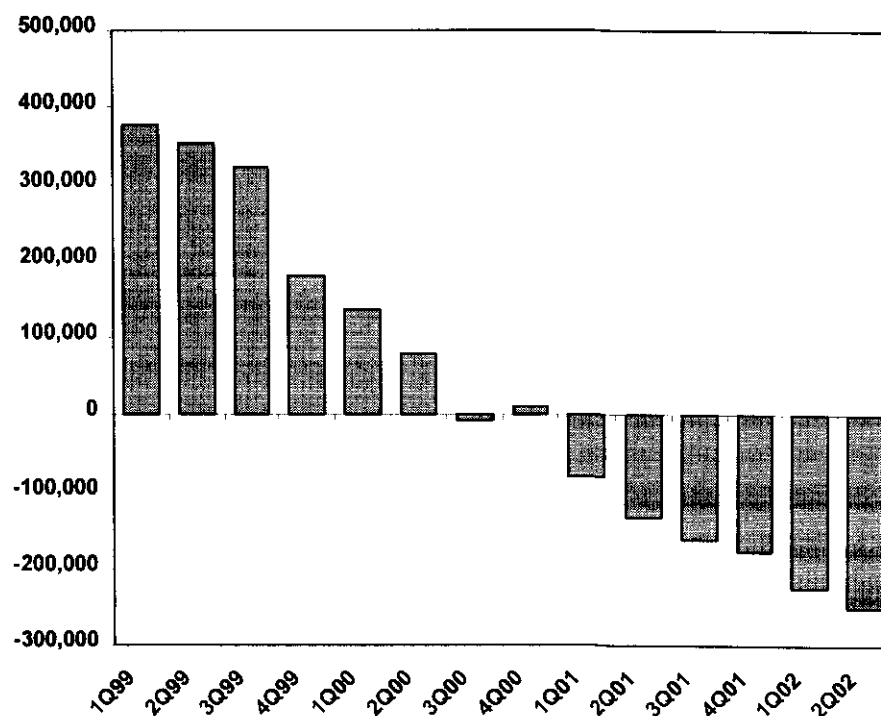
What Happened – Technological Competition

- **Wireless competition and broadband substitution have had a dramatic impact on BellSouth's embedded residential additional line base as well as the Company's ability to drive further penetration. The result has been increasing excess capacity, further pressuring the fixed cost structure of the Company's distribution network.**

Composition of BellSouth's 2.1 million Residential Additional Lines

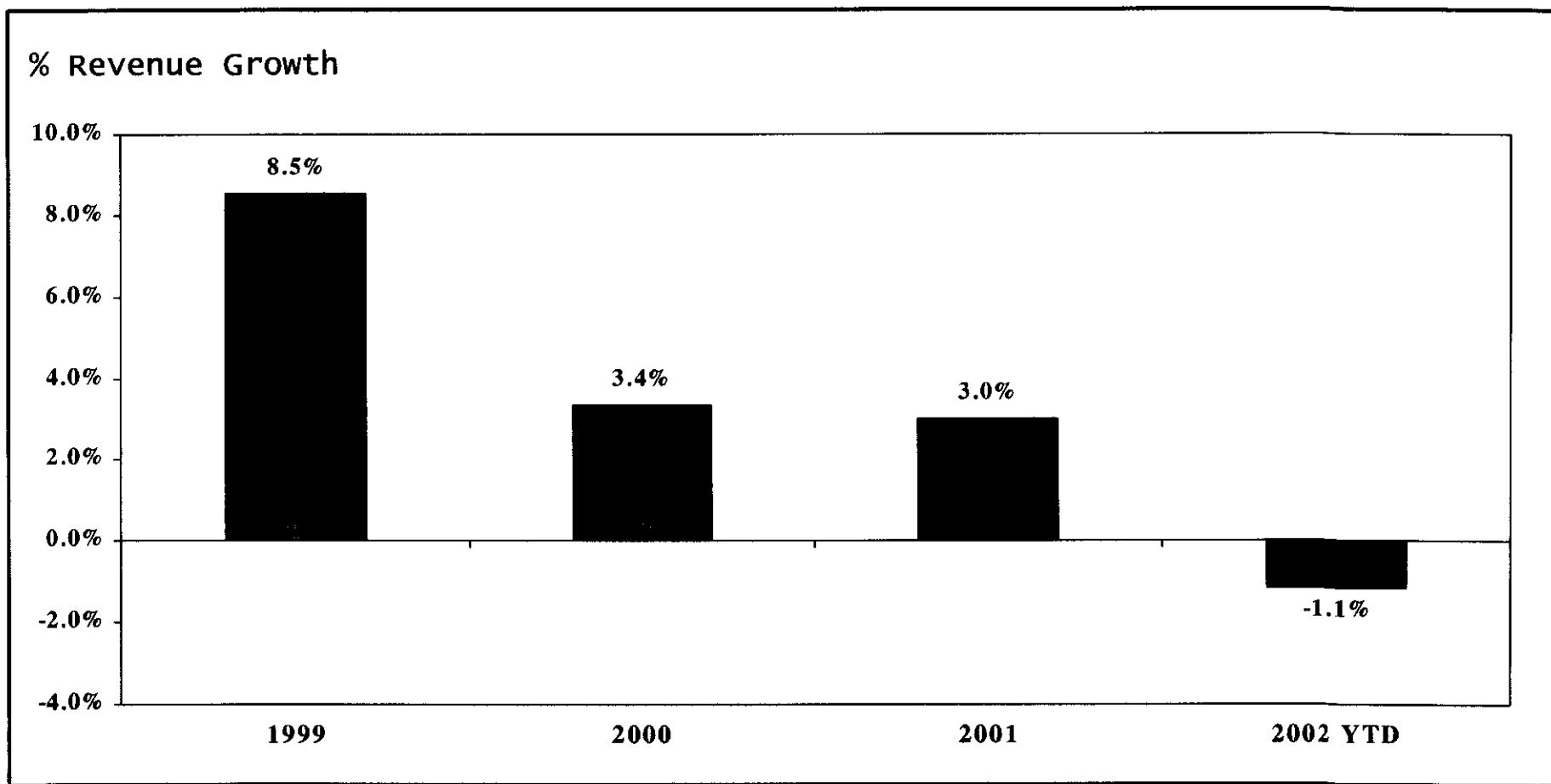


Quarterly Change in Additional Lines



What Happened? – End Result of the Four Pressures

- **The cumulative affect of access line losses to wireline and wireless competitors has driven BellSouth's top line growth negative in 2002.**



Proposed Solutions – Restore Financial Integrity

- 1. Attack Cost**
- 2. Create Conditions to Stabilize Network Economics**